NO. 12544

In The United States Court of Appeals
For the Ninth Circuit

MATANUSKA VALLEY FARMERS COOPERATING ASSOCIATION, a Corporation, *Appellant,*

vs.

C. R. MONAGHAN, *Appellee.*

APPEAL FROM THE DISTRICT COURT,
TERRITORY OF ALASKA,
THIRD DIVISION

REPLY BRIEF OF APPELLANT

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At the opening of his argument, counsel for appellee advances the view that only a question of fact is presented by this appeal, namely whether the dairymen sold their milk under paragraph (7) or under paragraph (8) of the contract.

> "This Brief, therefore, will be limited to an analysis of the evidence in the case. It is not found necessary to seriously dispute any of the propositions of law advanced by Appellant, nor to determine whether or not they are sustained by the authorities cited" (Brief of Appellee, p. 6).

We submit that such is not the case. Essentially what

ERRATUM: In the Brief of Appellant the following corrections should be made: At page 3, first paragraph, fourth line, under "Statement of Case," change "Title 26" to "Title 36." Make same change at page 39, in fifth line from bottom of page.

is presented is a question of law, as stated in the opening Brief of Appellant. This pertains to the interpretation of the Member's Standard Marketing Contract, taken as a whole, with respect to the facts presented.

Let us, then, refer very briefly to the Brief of Appellee and determine what answer is made with respect to each of the points heretofore presented by appellant in its Argument.

1. Appellee's Interpretation of the Contract Would Completely Defeat Its Purpose.

At pages 11 to 16 of the Brief of Appellant are summarized briefly the provisions of the contract in question. It is urged that all these provisions should be construed together to effectuate the purpose of the contract. The marketing contract, we suggested, would be converted into a mutual suicide pact if interpreted in such a way as to require the Association to drain off all profit in each department that showed a gain, retaining the losses only (R. 376). There were losses in some departments each year, it will be recalled, from the commencement of operation (R. 353).

In the Brief of Appellee the important point is evaded that its interpretation of the contract would have foredoomed the Association to failure years ago; that its notion of Association survival and paying out all profit in each profit-making department is self-contradictory. Counsel does state:

> "In the brief of appellant it is repeatedly urged that the payment of their obligation will deplete the assets of the association and defeat the entire

purpose of the colonization project. This is not a defense to a just claim nor is the history of the project and the relations of the association to the government any defense. Even if probable that payment would result in the failure of the project and the liquidation of its assets, the plaintiffs, as stockholders and as such part owners, would suffer in their just proportion without being called upon to donate their personal earnings to the ruin.

"It is inevitable that a corporation which cannot pay its debts must fail." (pp. 48-49).

However, this begs the question as to the nature of the "just claim" of plaintiffs. This is not simply a case of the Association's incurring or paying a debt. What is involved in the interpretation of the contract is a point so vital that it goes to the heart of the Association's organization and method of doing business.

2. Appellee Agrees With Appellant's Proposition That the Interpretation of the Contract Under Long-Established Practice of the Parties Is to be Given Great If Not Controlling Consideration.

At page 29 of Brief of Appellee, counsel, after setting forth the foregoing heading as entered in the Brief of Appellant (pp. 16-19), states simply:

"With this we agree." (Brief of Appellee, p. 29).

However, appellee promptly proceeds, again, to disregard the point involved by making no serious effort to find out what that long-established practice was *with respect to the question presented by this appeal.*

3. The Long-Established Procedure, Controlled by the Dairymen, Was for the Association to Distribute or Credit Any Profit It Made Back to Those Shareholders Who Sold Products to or Purchased Them from the Association In Profit-Making Departments.

The central point of difference between the parties thus narrows down to the subject matter considered under the above heading at pages 19 to 23 of the Brief of Appellant, which, of course, is supplemented by the material contained in succeeding headings of that brief.

After setting forth briefly the testimony covering prior practice with respect to distribution of earnings (Brief of Appellant, pp. 19 to 21) we stated:

> "Counsel for appellee may be challenged to point out any place in the record where any witness with direct knowledge of the Association's accounting or practice testified otherwise than in accordance with the foregoing." (Brief of Appellant, p. 21).

We submit that appellee has entirely failed to produce such testimony.

This is apparent from the "Review of Testimony," at pages 6-16 of the Brief of Appellee. Several points may be noted in this connection:

(a) The only witness referred to therein who had direct knowledge of the Association's established method of making payments to the dairymen is Mr. Snodgrass. Appellee sets forth three pages of his testimony. What counsel asked repeatedly of the witness was, whether the dairymen sold their milk at a flat "ultimate price." Mindful of the fact that whenever the Association had a profit it made payments in addi-

tion to the regular bi-weekly ones, Mr. Snodgrass, of course, phrased his answers in such a manner as to recognize the right of dairymen, as well as other shareholders, to secure a further, annual payment whenever funds for that purpose were available in the form of Association profit. In setting forth the testimony, appellee omitted, without designating the omission by asterisks or otherwise, the following statements of Mr. Snodgrass. This omission occurs in the record immediately after the sentence "A. That is what we have tried to follow," being the seventh line from the bottom of page 9 of the Brief of Appellee:

"Q. Then when you talk about finding yourselves with a profit at the end of the year and trying to redistribute that back to the people that contributed to it the most, you mean that you paid back the men that appear to have made a profit according to the profit they made? Is that really what you mean?

A. According to the profit the Association has made.

Q. According to the profit the unit—the dairy-creamery made, you fixed the final price of their milk?

A. No, according to that percentage of profit which that unit bore to the total profits.

Q. But you just stated you paid them off according to that Paragraph (7) as nearly as you could?

A. As near as we could and that was a considerable difference.

Q. According to your financial ability?

A. No, according to the distribution profits of the Association.

Q. Well, according to these figures the dairy-

creamery unit makes a profit of $57,000. Then you consider that a profit of the Association.

A. Well—

Q. Do you, or do you—

A. No, that might not be any profit at all to the Association.

Q. Now, this Paragraph (7) provides that you pay these men all you get for their milk after deducting anything you have advanced them, and after deducting.

A. Well, I know what it says". (R. 374-375).

Appellee disregards the testimony of Mr. Snodgrass elsewhere, in which he reiterates again and again that it is the profit of the Association that is distributed to producers each year (R. 352-354, 360-362; 365; 370-378; 453; 456; 470-490). Just a few lines further on in the record than the testimony quoted extensively by Appellee is the following:

"Q. What is it that has prevented you from paying them off entirely according to Paragraph (7) and not as near as you could?

A. Now, we are getting back—can I answer it at length?

Q. I hope it won't be too long.

THE COURT: Go ahead.

THE WITNESS: When the Association took over the operation it had both losing and profit-making unit—it had both losing and profit-making units, and the existence of losing units would not permit at any time the Association to distribute all its profits based upon just the departmental earnings because in that case, supposing that it had five units which made $10,000 and five units which lost $10,000, it would break even. But suppose it paid

out those five figures in black when its net profit or or loss shows zero, it would liquidate itself at the rate of $50,000 a year, which is a physical impossibility."

* * *

"Q. And you say since 1940 you have never purchased it under any other provision than Paragraph (7)?

A. No, I didn't say that". (R. 375-377).

(b) Appellee refers to testimony of other witnesses to the effect that they received bi-weekly payments accompanied with slips. We have covered this matter in our opening brief, and there is no dispute about that. The question presented by this appeal does not relate to these payments, but rather to the determination of the final, annual settlement when made.

(c) Appellee refers to no testimony given by any witness having direct knowledge on this point. On cross-examination the plaintiff Mr. Monaghan testified:

"Q. Do you know, Mr. Monaghan, what figures were used and how you arrived at the end figure, $3285.04, as being the amount you claim to be due to you?

A. I figured, prorated on the amount of milk I sold, on an equal share.

Q. Yes, now prorated against what? Mr. Monaghan, these slips you have shown the Court show that you were paid a certain percentage, I believe you testified, of the money you had already received that year. Now, is that the way you arrived at these figures, for the year 1945?

A. It would be on that basis, yes. Whatever is the share of the profit from the creamery prorated would be my share.

Q. All right, I think maybe you are getting somewhere now. On the profit of the creamery prorated according to some share?

Mr. Grigsby: Mr. Davis, I might save you time to say I made the computations and he don't know anything of how I made it". (R. 237).

Elsewhere Mr. Monaghan testified that his source of information was reports rendered by the Association at its annual and special meetings (R. 239-240).

At page 21 of the Brief of Appellee it is stated:

"The witness McAllister thoroughly explained, both on direct and cross-examination, that the bimonthly payments for milk delivered were advance payments. The prices adopted were advance prices, for the milk delivered" (R. 174-176; 190-192; 209-212).

This is what Mr. McAllister testified on the point at hand:

"Q. Now, in '42, '43 and '44, of those fiscal years did you receive additional payments over and above the payments advanced?

A. I did.

Q. After the books were audited, is that right?

A. Yes.

Q. And did they ever furnish you a statement of the deductions which fixed the final payment, or did you have access to the books to see that, or was it explained?

A. It was explained. We had access to the books, but I never took advantage of it.

Q. Who was the manager during those years?

A. Well, there were three, I believe. There was Mr. Stock, and Mr. Snodgrass, and then—of course, that was this year—I guess there was just two." (R. 176-177).

Mr. Quarnstrom, one of the other assignors who testified, threw no light on the point. As a matter of fact, he indicated that the dairymen in his view were entitled only to "a large percentage" of the $57,001.85 shown as profit in the creamery-dairy department, upon some basis of reckoning not disclosed (R. 411).

Mr. Cope, another assignor, used the word "dividend" in his testimony, a word which counsel for appellee would avoid. There is nothing in his testimony inconsistent with the explanation of what was done as set forth in the Brief of Appellant (R. 438-439).

At page 13, appellee refers to a conversation which Mr. Rempel, one of the other assignors, had with Mr. Snodgrass in 1944, in which Mr. Snodgrass is reported to have said that "profit, on the milk" is divided at the end of the year (R. 388). Such a conversation throws little light on the point at hand, being vague at best and subject to the vagaries of the witnesses' memory.

(d) The appellee carefully avoids any reference to two other witnesses besides Mr. Snodgrass, the only others who did have direct knowledge on the matter at hand: Mr. Stock, the manager for the Association, who established the system of payments and distribution (R. 573-576), and Mr. Allyn, the accountant and assistant general manager (R. 265-267). Since their testimony clearly supports appellant herein, the appellee ignores it.

(e) Reference is made by appellee to a meeting, not of the board of directors, but "just an informal meeting" (R. 197-198), at which the statement is attributed to "either Virg Eckert or Mr. Stock" (R. 198) to

the effect that the Association was morally obligated to pay the $57,001.85. Mr. Stock explained this as follows:

> "Q. Now, Mr. Stock, is there anything else that you can add to clarify to the Court some of these matters that I haven't asked you about?
>
> A. Only in the set-up there we have a unique organization. In most cooperatives they are organized for one particular purpose, either to sell milk, to sell beans, to retail merchandise or to handle one commodity—eggs or butterfat or milk or whatever it might be. The very nature of the installation up there — they have various activities and, of course, they must be intermingled. It was set up originally with federal funds and then became the cooperative, making it possible for them to take over by borrowing federal funds. It immediately became an obligation upon all the Association, and when this question was first presented to the Board, of which I was a member, our attitude was that there was $2800 to distribute and we knew of no legal or any other obligation that would permit us to segregate one unit away from the other and distribute as overages anything other than the profits indicated by the Association as a whole. It was our belief, and we have been taught—I have been taught, in my business life—that it is not proper to distribute earnings out of anything except earnings. It cannot come out of capital, and that was my reason for my decision and the answer that I gave the boys at that time. While I sympathized with them, it was one of those things I could see no out on. If any other policy had been followed the Association would have been broke a long time ago." (R. 575-576).

(f) Reference is made, at page 15 of the Brief of

Appellee, to a stipulation made by counsel relating to evidence on payments. In order that there be no misunderstanding about this, we point out that the stipulation went no further than that the other assignors "would testify as Mr. Cope and Mr. Rempel and Mr. Quarnstrom have testified as to how their payments were made." As stated by Mr. Davis:

> "That stipulation will be something to the effect that they received payments bi-weekly, based on the amount of milk sold at such and such a fixed price, once again not saying the price was to be the final price, but on a fixed basis, and then at the end of each year received additional payments." (R. 442).

(g) At pages 16 to 20 of the Brief of Appellee, reference is made to the Association's Audits for 1944 (Defendant's Exhibit 1) and 1945 (Plaintiff's Exhibit VI) respectively, under the heading "Reports of Audit." Here, again, appellee discussed detail not pertinent to the question presented before us, namely, whether the practice of the Association was to pay out all profit credited on the books to the dairy-creamery department back to the dairymen irrespective of what the profit of the Association as a whole might be.

The matters of "indirect overhead," costs and operating expenses are covered at pages 31-33 of the Brief of Appellant.

We submit that the real question is, what was actually done, in substance and reality?

(h) Appellee took the position that the distribution made in accordance with the 1944 audit was satisfactory. Counsel for appellee asked his own witness, Mr. Rempel:

"Q. You were satisfied, were you, Mr. Rempel, with the way this matter was handled in 1944?

A. Yes." (R. 393)

Mr. Quarnstrom also so testified (R. 409).

Accordingly, the entire case for appellee collapses if the audit for 1944 shows that something less than the profit credited to the dairy-creamery department in fact was paid back to the dairymen.

This is clearly the fact. The profit credited to the dairy-creamery department in the 1944 audit was $66,961.03. The profit for the Association as a whole is given as $61,580.27, the difference between these two figures being represented by losses as to the "Fountain" and "Produce Department" (Def. Ex. 1, p. 3; R. 604). Now if appellee were correct in his view of what the prior practice of the Association was, he should be able to show that $66,961.03 was paid to the dairymen. However, the audit shows that only $47,416.19 was paid.

At the trial, counsel for appellee specifically examined witnesses on the point that over $18,000.00 credited on the books to the dairy-creamery department for 1944 had not been paid to the dairymen.

"Q. So that there was left remaining there to the credit of the net profits of the dairy-creamery for the year 1944 the sum of $18,943.42. Now you were manager at that time: do you know what use was made of that money?" (R. 447)

Mr. Snodgrass, to whom the question was directed, then explains in detail again the mechanics by which the Association distributed its surplus earnings (R. 447-456).

A little further on in the testimony, further questions are asked of Mr. Snodgrass as to how the money happened to be withheld from the dairymen in 1944.

> "Mr. Grigsby: Referring back to that 18,000 and some odd dollars that was held out, or remained from the net profits of the creamery and dairy for the 1944 production, after paying additional payments of 20 per cent and 21.125, was there any agreement made with the dairy farmers that that amount should be held out, or was nothing said about it?
>
> A. I believe that there was nothing said about it.
>
> Q. They seemed to be satisfied? That's all.
>
> A. Well, it's altogether in a sort of negative sense. They have raised no objection and they always come in at the audit and see the figure is there. So it shows—
>
> Q. They have the legal privilege of coming in and seeing it?
>
> A. That's right.
>
> Mr. Grigsby: That is all." (R. 520).

Finding himself at a complete loss to explain how the Association could have retained this money in 1944, appellee then suggested through his assignor Mr. Huntley that perhaps dishonest motives entered into the matter:

> "Q. Now, you have heard it testified to here today—a reference made, anyway—to some $18,000 odd retained by the co-op out of the net profits of '44 after making those additional payments? Did you hear that testimony?
>
> A. I did.
>
> Q. Did you know—when did you first know that they retained that?

A. Today.

Q. When you were paid off in '45—your final payment on what was called the milk pool of '44—did you assume, or did you know there was anything left of the net profits of the creamery-dairy?

A. I did not.

Q. What was your idea as to what had become of all the net profits?

A. I thought that all the net profits were being paid to the producers.

Q. And why did you think that?

A. It never occurred to me to question it.

Q. You mean you had confidence in their—

A. I did. I thought we were a group of honest individuals and that everything was above board." (R. 525-526).

All of which goes to show simply that the appellee was surprised to find that the 1944 audit discredits the theory which he strives to support.

This same audit contains a recapitulation of data for prior fiscal years and indicates that the prior practice each year was the same. Thus, page 16 is entitled "Undivided Profits" and shows the balance as of December 1 for each of the prior years 1939 through 1943.

The audits for 1945 and for 1944, respectively, were made by the same accounting firm, Neil, Clark and Company of Fairbanks, Alaska. Placing them side by side, one perceives that the same methods were used in each. It is apparent that the only real difference in result is that in 1944 the Association made a substantial profit while in 1945 it did not.

Without apparent realization of the observation,

counsel for appellee virtually concedes all that has been said, above, with respect to prior practice in distributing net earnings. Counsel stated:

> "The $18,943.42 retained by the Association was used according to the testimony of Snodgrass, the manager, 'to plug up different holes' where the Departments made a loss (R. 511). The dairymen had made no complaint of this apportionment as the cash advances plus the additional payments gave them an acceptable return for the milk sold. This was likewise true of all the previous years' operations.
>
> "But for the year 1945, the Association, having many more 'holes to plug' kept all the profits, and decided that it had bought the milk at a flat price. The trial Court found against this contention and that the dairymen were entitled to a judgment for $28,700.60." (Brief of Appellee, p. 47).

While the statement is correct that in 1945 the Association "kept all the profits" the fact should be recalled that it made only $2,889.27 in that year (Pl. Ex. VI, p. 2, R. 604).

4. Paragraph (7) of the Contract Does Not Determine The Question Presented By This Appeal.

Under this heading in the Brief of Appellant, four points designated (a) to (d) were listed (pp. 26-31).

Appellee disregards these points. but does attempt to avoid what was said there as to the untenable theory of "advances" by classifying the bi-monthly payments as "advance price." This phrase has no meaning unless it is, that it is a price paid before, or in advance of, the annual distribution of profit.

5. Even if Paragraph (7) Were Held To Govern, When Interpreted In The Light of The Practice of The Parties, It Would Support The Position of Appellant Herein.

What has been said above covers this point, which receives scant attention in the Brief of Appellee. As to this, as well as other points referred to, the underlying proposition must be accepted as a starting point, that it was the established practice of the Association to make its annual payments out of net profit of the Association. Once appellee concedes, as he has, that this practice governs the rights of the parties, the applicable paragraphs of the contract, whether deemed (7), (8), or otherwise, must be construed on that basis.

6. In Practice The Parties Applied Paragraph (8); The Bi-Monthly Payments Were Prices For Milk Delivered On Cash Sales and The Annual Payments Were Dividends Proportioned Upon Such Sales.

In the course of discussing paragraph (8) of the contract, appellee makes the following statement:

> "There is no testimony in the record that the dairymen were * * * at any time informed that they had been selling their milk at a flat price and that they had nothing coming." (Brief of Appellee, p. 26.)

This statement apparently assumes that notice would be necessary to a dairyman for the Association to invoke paragraph (8), but there is no provision therein requiring any such notice.

Appellee lays much store by the fact that the word "dividend" was not used. We have seen that the word

"overage" was. Whether used or not, it is, again, the substance of the transaction rather than verbiage that it important.

Appellee concedes that the products when delivered became the property of the Association:

> "It has been maintained by Appellant and is conceded by Appellee that from the time the Association went into the retail milk business in 1940 they purchased the dairymen's milk under the provisions of the Member's Standard Marketing Contract, and that, whether they purchased the milk under the provisions of paragraph (7) or paragraph (8) of the Contract, when delivered it became the property of the Association. When sold the proceeds of the sale became the property and assets of the Association." (Brief of Appellee, p. 28).

This being conceded, it is submitted that points (a) through (f) follow which are set forth in the Brief of Appellant under the same heading as that here being discussed (pp. 33-39).

The only point made by appellee in this connection apparently is, that pasteurization does not constitute a process within the meaning of paragraph (8) of the contract, providing for a flat delivery price as to such products as "it may process or manufacture . . . into changed or new products" (Brief of Appellee, p. 27). This disregards the definition of "process" in Webster's Dictionary, and the usage illustrated by authorities cited (Brief of Appellant, pp. 35-37). It may be noticed, moreover, that the processing of the milk involved not only pasteurizing but also testing, grading, standardizing and bottling.

7. Payment of The Amount Demanded Would Constitute A Payment Out of Capital In Violation of The Laws of Alaska, The Articles and By-Laws of The Corporation.

Appellee seems to agree with this proposition, discussed at pp. 39-44 in the Brief of Appellant, except that appellee repeats his contention that the payment is not a dividend. What has been said is sufficient on the point that in substance it is just that.

At pages 30 to 37, appellee in his brief urges that payments to dairymen could not be a dividend because Alaska Compiled Laws Annotated, 1949, Section 36-3-8, as well as the articles of incorporation and by-laws of the Association, contemplate that any dividend be "uniform" as to all shareholders. What the Association did, as we have seen, was to determine as far as possible the amount of profit made by it from each shareholder and return it to each as far as prudent business practice would permit. All shareholders were treated uniformly in this respect, the classification by departments being utilized simply as a guide to management and a convenient means of accomplishing this distribution. No case can be cited where either the law of Alaska or any comparable articles or by-laws were ever interpreted so rigidly as to invalidate this practice.

If appellee is correct, he has succeeded in proving that the dairymen in prior years had received more than they were entitled to. And any argument to the effect that paragraph (7) of the contract governs would be of little avail in any effort to make the annual payment legal under the law of Alaska simply by calling it something else than a dividend. If in substance that is

what it was, it would be legal or illegal irrespective of what the marketing contract said on the point.

In various parts of the Brief of Appellee criticism is directed at the method of doing business pursued by the Association. What is overlooked is, that it was the dairymen who were in majority control of the Association at all times (R. 491, 575). This was true even though they numbered only 27 to 29 out of a total membership of about 130 (R. 574-575). In any event, 1945 is an isolated year when a substantial profit was not made, as contrasted with heavy losses incurred when the operations were in the hands of the predecessor of the Association, the Alaska Rural Rehabilitation Corporation.

Appellee implies that the dairymen were penalized by having to subsidize losing departments. This had been the practice since the Association was chartered. To be noted is the fact that the dairymen did not confine their activities to dairying solely; some of them at least raised produce and other commodities which were marketed through departments that lost money. This was true, for example, of Mr. Quarnstrom (R. 415-416), Mr. Ising (R. 422) and Mr. Johnson (R. 424), assignors of plaintiff. In other ways, too, they received benefits from losing departments (R. 323-325). Further, the dairymen, if operating their department alone, would have a disproportionately high overhead, now distributed over the losing departments (R. 482).

The principal point to be noted is, that the dairymen received the benefit of the acquisition by the Association of the dairy-creamery plant at Anchorage. Each dairyman put up only the $5.00 required in the Stand-

ard Marketing Contract of all other producers. Yet, it was through this acquisition, and the establishment of direct-to-consumer sales that the creamery-dairy department was converted from a losing one at the start into the most profitable of all. This matter is covered at pages 22-23 of the Brief of Appellant.

Criticism is implied of Mr. Allyn, the accountant, for not having made a segregation of costs as between the creamery and dairy portions of the creamery-dairy department (Brief of Appellee, pp. 43-46). What has been said with respect to the dairymen controlling the business applies here, also. Furthermore, appellee called Mr. Allyn as his own witness when the latter had been in the employ of the cooperative for two months only (R. 248, 290). The appellee could have secured the auditor from Fairbanks who had made the regular annual audits in prior years, or invoked other pre-trial procedure to secure any information obtainable. In any case, the data is irrelevant to the issue presented by this appeal.

Respectfully submitted,

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